Statement of the Alliance of American Insurers

on the

Value of Credit Scoring in Personal Lines Insurance

Delivered to Commissioner Fitzgerald

Good evening Commissioner. I am representing the Alliance of American Insurers. The Alliance is a national property casualty trade association, based in Downers Grove, Illinois, with over 300 member companies. The Alliance commends you and your staff for conducting public hearings on the issue of insurer use of credit, and we appreciate the opportunity to provide our views on the issue.

The Alliance believes that insurers should maintain the right to consider credit information in both their underwriting and rating decisions. We believe that credit history and credit-based insurance scores are fair and accurate tools that allow insurers to select and rate risks with greater certainty. Further, we maintain that consumers directly benefit from insurer use of more sophisticated underwriting and rating tools. However, the Essential Insurance Act already precludes insurers from considering credit in their underwriting decisions in Michigan. Therefore, it is critical to preserve the right of insurers to consider credit information in their pricing decisions; and it is critical to allow consumers the right to seek out insurers who may offer actuarially-justified discounted rates based on their favorable credit history.

It is important to understand how insurers use credit information. Unlike lending institutions that consider credit histories and credit scores to determine one's ability to repay a loan, insurers consider credit information or credit-based insurance scores ("credit scores") to measure one's ability to *manage* credit. Credit-based insurance scores actually represent an objective and fair way of measuring subjective factors – factors of responsibility and stability.

The relationship between credit and insurance risk may appear strange until one looks at the broader picture – that a person with a proven track record of responsibility, as reflected in their ability to manage credit, will typically manage insurance risk in the same responsible manner. There are numerous studies and actuarial reports available to illustrate the clear correlation between credit score and insurance loss. We would be happy, upon request, to provide copies of some of the published research on this issue.

Credit-based insurance scores are primarily affected by credit habit *patterns*. So a person with a rare late payment or someone who has prudently initiated several credit inquiries while shopping for the "best deal" will not likely have a poor credit score. Further, credit-based insurance scores do not discriminate against lower-income individuals. In actuality people of all economic levels have good and bad credit records. Income is NOT a factor considered in a credit-based insurance score.

In addition to income level, address, ethnicity, religion, gender, familial status, nationality, age, and marital status are also NOT considered within a credit-based insurance score calculation.

Some opponents of insurer use of credit information have charged that insurers use credit information for the purpose of charging higher premiums. We disagree with this charge. Insurers are in the business to write and retain policies. Any insurer who would attempt to unfairly rate or tier their policies, would not remain in business very long. On the contrary, credit information has proven to be an effective tool for insurers, allowing them to underwrite or rate business with a greater degree of certainty and accuracy. Further, our member companies repeatedly tell us that the vast majority of applicants and policyholders have *good* insurance scores, and that the *majority* of risks receive a discount based on favorable scores. For example, one of our member companies has told us that 90% of their policyholders receive a discount based on their insurance score. This means that, if insurers are prohibited from establishing a discount plan based on credit information, that same majority of policyholders would likely see a premium "increase" as those policyholders would be required to subsidize others.

Privacy is another issue that has been raised in opposition to the use of credit information. Today, more than ever, consumers are concerned with privacy and confidentiality of personal records. We don't believe that the use of credit reports, either directly, or indirectly through scoring mechanisms, is intrusive. Insurers must employ strict confidentiality procedures in their use of credit histories. And the use of scoring allows the underwriter to objectively consider credit information and credit management habits without having to scrutinize all the details of one's credit history. Likewise, an applicant or policyholder will not have to fear that every detail of his private credit information will become known to his agent – who may be a family friend or neighbor. Consumers need not feel that their insurer's use of a credit history will jeopardize their privacy.

Some people have also voiced concern over possible inaccuracies or errors in their credit records. While errors obviously occur, their impact on insurance underwriting has been negligible. Often errors found on credit reports are not relevant to the information considered by insurers. In fact, insurance scores are based on information far more accurate than motor vehicle records. However, if credit information is found to be in error, the Federal Fair Credit Reporting Act (FCRA) already clearly protects consumers by prohibiting insurers from considering information known to be in error. The FCRA, which gave insurers the right to consider credit information nearly thirty years ago, also requires insurers to disclose the source of adverse information to policyholders and to advise policyholders how incorrect information may be disputed and corrected.

Finally, if an applicant or policyholder objects to an insurer's practice of reviewing a credit report or credit-based insurance score, that person is free to shop for another insurance company that does not consider credit information. An insurance policy is a contract between an insurance company and the policyholder - a purchased service, not a right. Therefore, if a policyholder objects to an insurance company's use of credit reports, that person is free to shop for another insurance company that does not consider credit information.

Just as not all insurers will choose to use credit information in their decision-making and rating process, those that do will not all use them in the same manner. Nor would we want them to all use it in the same manner – that would take away much of the competition necessary for a healthy insurance market.

The Alliance believes that the use of credit reports and insurance scores has positive overall effects on consumers. For some applicants and policyholders it can become an emotional issue. Sometimes people fall on hard times and good people end up with bad credit records. But again, a *score* allows an underwriter to look at a trend – not just a few incidents. Further, older items will carry less weight – so our mistakes don't haunt us forever.

It is true that some policyholders will not be eligible for discounts based upon their insurance score or based upon information in a credit report. But then, some applicants will also be subject to higher premiums due to an unfortunate traffic accident – maybe their first in years. So while some say that it is not "fair" for insurers to consider credit information, we believe that just the opposite is true. All consumers deserve to be rated as accurately as possible, and given the most favorable rate applicable for their exposure.

Credit-based insurance scoring is an effective tool for insurers - and a fair one for consumers. To protect competition and consumer choice, it is imperative that insurers be permitted to fully price risks using nondiscriminatory and statistically valid tools available to them.

The Alliance of American Insurers appreciates the opportunity to provide our comments. Thank you for your time.

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